
IN THE SUPREME COURT OF MISSOURI

STATE OF MISSOURI EX REL. ATMOS ENERGY CORPORATION, et al., Appellants, vs.	)	**Case No. SC84344**
PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI, et al., Respondents. and AMEREN CORPORATION and UNION ELECTRIC COMPANY, d/b/a AmerenUE, Appellants, vs. PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI, et al., Respondents.	)	

Appeal from the
Circuit Court of Cole County, Missouri
19th Judicial Circuit

SUBSTITUTE REPLY BRIEF OF APPELLANTS AMEREN CORPORATION AND UNION ELECTRIC COMPANY, D/B/A AMERENUE

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INTRODUCTION

This Reply Brief responds to arguments made by both the Respondent Public Service Commission ("Commission") and by Intervenor-Respondent Office of the Public Counsel ("OPC"). Because neither of their briefs follow the order of UE's Initial Brief, UE responds to their arguments in the order presented in its Initial Brief.[1]

Much of the Commission's Brief seems premised on general statements about the laudible purposes of the Public Service Commission Law (the "PSC Law"). Resp. Brf. at 25-26, 28-29. The Commission plainly wants this Court to believe that "cross subsidization is bad" and therefore "the Rules are good." Resp. Brf. at 28-29. UE's

[1]With respect to UE's Point I, the Commission has generally agreed with UE's discussion thereof and the OPC has not addressed the issues presented by UE's Point I. UE therefore does not discuss its Point I herein.

opposition to the Rules[2] is not an endorsement of cross-subsidization. UE does not dispute that the Commission has broad discretion over policy considerations within the Commission's jurisdiction. It is axiomatic, however, that the courts are under no duty to defer to the Commission in interpreting and enforcing the laws governing Commission actions and that the reasonableness of the Rules is irrelevant if the Rules violate the PSC Law itself or other applicable law.[3] In short, UE contends that the Commission has ignored very basic provisions of the PSC Law and by doing so has, in effect, unlawfully amended those statutes, thereby unlawfully nullifying the Legislature's will as reflected therein. *State ex rel. Springfield Warehouse & Transfer Co. et al. v. Pub. Serv. Comm'n*, 225 S.W.2d 792, 794 (Mo. App. W.D. 1949) (The Commission "has no power to adopt a rule, or follow a practice, which results in nullifying the expressed will of the Legislature").

[2]For ease of reference, a citation to the Rules refers to the rules issued in all four rulemakings that are the subject of this appeal. When specific sections are cited, UE will cite to the electric utility rules in 4 C.S.R 240-20.015, unless otherwise noted.

[3]*Friendship Village of South County v. Pub. Serv. Comm'n*, 907 S.W.2d 339, 344 (Mo. App. W.D. 1995) ("The standard of review of the Commission's order is two-pronged; first, it must be determined whether the Commission's order is lawful; and second, we must determine whether the order is reasonable . . .").

A. The asymmetrical pricing standards are more than a mere "statement of policy" and create a rule of law that nullifies the express will of the Legislature as reflected in Section 393.140(5).

The asymmetrical pricing provisions of the Rules provide, in explicit, unambiguous, and mandatory terms, that a regulated utility "shall not provide a financial advantage to an affiliated entity" Section (2)(A). The very next sentence provides that the regulated utility "*shall be deemed* to provide a financial advantage . . ." if the asymmetrical pricing standards ("APS") are not met. *Id* (emphasis added).

The Commission downplays the foregoing provisions by asserting (in its role as an advocate attempting to sustain its Orders promulgating the Rules) that the APS in the Rules do nothing more than give utilities "advanced notice" of the Commission's views. Resp. Brf. at 71. The language employed by the Commission rebuts that contention, and has overwhelmingly been held to create a conclusive presumption. *See, e.g., Ohio Power Co. v. Federal Energy Regulatory Comm'n*, 954 F.2d 779 (D.C. Cir. 1992) and the cases cited therein. Furthermore, if, as the Commission now contends (although the record before the Commission is devoid of any such indication), the APS are nothing more than a "policy statement" or a "notice" to utilities, the standards cannot lawfully bind the utilities or be used in any way to the utilities' detriment. *Davis & Pierce, Administrative Law Treatise*, §B. 2 (3d ed. 1994). The Commission's argument that it duly engaged in a long and complicated rulemaking proceeding and issued rules making various acts

unlawful, while at the same time indicating (now) that they do nothing more than announce a Commission "policy" that essentially binds no one, is illogical.

Case law refutes the Commission's contention. While not identical to the present case, *Ohio Power* is similar factually to the issue presented in this case because it involves interpretation of a regulation by a body charged with regulating rates, specifically the language "shall be deemed" in that regulation, and the Court interprets that language while examining the propriety of the pricing in a transaction between a regulated utility and its unregulated affiliate (i.e., an "affiliate transaction"). In *Ohio Power*, the Federal Energy Regulatory Commission ("FERC") disallowed, in Ohio Power's wholesale power rates, the cost of purchases of coal by Ohio Power from its affiliate, Southern Ohio Coal Company ("SOCCO"). *Id.* at 780. Ohio Power appealed the disallowance on, in part, the basis of a FERC regulation that provided as follows:

> Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost *shall be deemed* to be reasonable and includable in the adjustment clause. Id. at 783 (citing 18 C.F.R. § 35.14(a)(7) (emphasis added)).

The FERC regulation was applied there because Ohio Power's fuel purchases from SOCCO were subject to SEC regulation since Ohio Power is a subsidiary of a registered holding company under the Public Utility Holding Company Act ("PUHCA"). The Court held, therefore, that since those purchases were subject to SEC regulation, the cost was reasonable under the FERC's own regulation, and the FERC could not disallow

the costs. The D.C. Circuit agreed, holding that the FERC regulation created a conclusive presumption that foreclosed the FERC's disallowance of the costs. *Id.* at 783-84.

The FERC, like the Commission here, argued that its regulation did not mean what it plainly said; that is, that the word "deemed" created only a rebuttable presumption. This is the same argument the Commission apparently tries to make in the present case: " 'considered' or 'presumed' are *closest* to the Commission's intent." Resp. Brf. at 73 (emphasis added).

The court easily disposed of the FERC's contention in *Ohio Power*. First, the court noted that when the agency's interpretation is contrary to the "plain meaning of the text," the courts owe the agency "no deference." *Id.* at 783. Missouri's courts have held the same. *See, e.g. Tate v. Dir. of Revenue*, 982 S.W.2d 724, 728 (Mo. App. E.D. 1998); *Emery v. Wal-Mart Stores, Inc.*, 976 S.W.2d 439, 449 (Mo. banc. 1998). Thus, the Commission's argument that this Court should defer to its post-adoption views for which the record before the Commission lends no support is incorrect. Rather, this Court exercises unrestricted, independent judgment on matters of law, including the interpretation of the plain and unambiguous language of a rule. *Friendship Village*, 907 S.W.2d at 344; *State ex rel. Utility Consumers Council of Missouri, Inc. v Pub. Serv. Comm'n*, 585 S.W.2d 41, 47 (Mo. banc. 1979).

The *Ohio Power* court aptly summarized the applicable law regarding the phrase "shall be deemed":

> He then found that "courts construing the word 'deemed' have generally found that it establishes a conclusive presumption." (citing, e.g., **H.P. Coffee Co. v. Reconstruction Finance Corp.**, 215 F.2d 818, 822 (Emerg. Ct. App. 1954) (finding near "unanimous judicial determination that the word [deemed], when employed in statutory law, creates a conclusive presumption.")). * * * Given the unambiguous character of deemed, then, we find case law amply supports our finding that the plain language [of the FERC regulation] requires FERC to include in Ohio Power's wholesale rate the SEC-approved cost-based price for SOCCO coal. 954 F.2d at 783.

The FERC (as does the Commission here) protested the finding of a conclusive presumption by attempting to "cloud the clear meaning of deemed by pointing to the complicated rulemaking history of § 35.14(a)(7)." *Ohio Power*, 954 F.2d at 783. The court rejected this attempt finding that "prior administrative pronouncements regarding the meaning of § 35.14(a)(7) [are] of little moment to the extent they are not consistent with the unambiguous terms of the regulation." *Id.* Furthermore, if "FERC wishes to have § 35.14 (a)(7) create only a rebuttable presumption, *then it may do so explicitly through the required process*." *Id* (emphasis added).

It is a settled tenet of administrative law that judicial review of an agency's action is confined to the grounds upon which the agency itself based its action; post hoc rationalizations are insufficient to support the agency's decision. *See, e.g., Overton Park v. Volpe*, 401 U.S. 402, 419, 91 S.Ct. 814 (1971). *See also, S.E.C. v. Chenery Corp*., 318

U.S. 80, 88, 63 S.Ct. 454 (1943). The Commission's belated statement to this Court that it meant something different than the clear meaning of "shall not provide a financial advantage" and "shall be deemed" is a clear attempt to cloud the clear meaning of the language chosen by the Commission in an effort to avoid acknowledging that imposing the APS is directly contrary to the adjudicatory requirements of Section 393.140(5). If, as the OPC stated, the "asymmetrical pricing standards are the Commission's *statement of policy* indicating the treatment the Commission *intends* to afford a particular cost of service item," then it is illogical that the Rules *prohibit* a financial advantage (by providing that a utility "shall not" provide one) and *deem* a failure to meet the standards to be a prohibited financial advantage. OPC Brief at 89. It is unreasonable to provide for such mandatory standards and prohibitions in a duly promulgated rule and then, while fending off an attack on their validity, degrade the rule to a mere statement of "policy."

Not only does the Commission struggle now to find an alternate meaning, but the only case it cites in support of its shaky attempt to do so is a case in which this Court held identical language created a conclusive presumption. *See Fabick and Company v. Schaffner*, 492 S.W.2d 737, 745 (Mo. banc. 1973) ("The contention that only a rebuttable presumption was intended is rejected").

B. Application of the APS demonstrates their direct inconsistency with Section 393.140(5).

There are at least two examples of when the APS violate existing law, as the Commission or a private complainant could use (or misuse) the presumption created by

the Rules in direct contravention of Section 393.140(5). A complainant could seek to bar a utility from engaging in a particular affiliate transaction or class of affiliate transactions on the basis that such transactions result in undue or unreasonable preferences or advantages. Or, a complainant could seek a rate reduction against the utility, because the utility's rates include costs made unlawful by the Rules.

In the first instance, the Rules unlawfully relieve the complainant of its burden to prove, by substantial and competent evidence of record, whether the act (the affiliate transaction(s) at issue) resulted in an undue or unreasonable preference or advantage. Thus, the Commission's statement that it will "have a hearing" prior to disallowance of a transaction (Resp. Brf. at 72) would be little help to the utility who now faces a hearing in which the complainant's burden has been discharged via the Rules. An example illustrates this point.

Assume that a complainant files a complaint against a utility and alleges that a particular transaction or series of transactions have resulted in an undue or unreasonable preference or advantage because the transactions do not meet the APS in the Rules. Prior to adoption of the standards, there is no question that the complainant would have to (a) go forward with evidence to support the existence of an undue or unreasonable preference or advantage and (b) carry its burden of persuasion with respect to the existence of such preference or advantage. The Commission agrees that "whichever party has the burden of proof always has the initial burden of [going forward with] the evidence . . ." Resp. Brf. at 75 (*citing Hautly Cheese Co. v. Wine Brokers, Inc.*, 706

S.W.2d 920, 922 (Mo. App. W.D. 1986)). Armed with the presumption created by the Rules, however, the complainant has now been relieved of its entire burden.[4] All the complainant now has to do is to show that the transaction at issue did not meet the APS, even if failure to meet those standards *does not result in an unreasonable or undue preference or advantage*, and even though the complainant was not required to go forward with any evidence with respect thereto. The Rules compel the result that if the transaction does not conform to the APS, the utility is "deemed to [have] provide[d] a financial advantage." In short, if the Commission's position on the Rules is sustained, the Commission will have created a ready-made mechanism, via an administrative rule, that relieves it and any other complainant of their burden of going forward (and we contend their ultimate burden of proof) to establish by substantial and competent evidence of record that the unfair advantage exists.

The effect of the Rules is to allow the Commission to totally abdicate its legislatively prescribed duty to adjudicate whether, in fact, an unreasonable advantage has occurred. The Rules further result in a total abdication of the Commission's responsibility to determine whether ratepayers have been harmed such that a finding of

[4]Or, if it is only a rebuttable presumption, as now alleged by the Commission (Resp. Brf. at 74), the complainant has at a minimum been relieved of its burden of going forward – an equally unlawful result because the utility is forced to at least come forward with evidence that it had not granted the advantage, a burden that is contrary to the allocation of burdens prescribed by the Legislature under the PSC Law.

an unreasonable or undue preference or advantage is justified. The Commission must make such a finding via adjudication based upon substantial and competent evidence of record before it can disallow the subject transaction. *State ex rel. Gen. Tel. Co. v. Pub. Serv. Comm'n*, 537 S.W.2d 655, 662 (Mo. App. W.D. 1976) (The Commission is not empowered to substitute its judgment regarding expenditures the regulated utility makes absent an abuse of discretion by the utility).

A further example also illustrates how the Rules undermine this longstanding legislative process.

Assume that a regulated gas utility has an unregulated affiliate that provides risk management products to utility companies. Assume further that this affiliate decides to buy gas futures contracts in the Spring allowing it to buy gas at $4 the following January. The unregulated affiliate trades in these futures contracts with numerous utilities, and not just with its utility affiliate. The gas utilities do business with these risk management firms because their management has determined that it is inefficient, over time, to maintain a "risk management department" within these utilities because they have a sporadic need for such services. Assume now that January comes, the market price for gas is $10, the regulated gas company is about to run short on gas, and the risk management affiliate is selling gas to its non-affiliated gas utilities for $7. Finally, assume that if the regulated gas company at issue had set up its own risk management department, it could have, in this instance, obtained gas at a fully distributed cost of $6. In that scenario, the risk management affiliate has a disincentive to sell the gas to its

regulated affiliate for $6 because it can sell it to others (probably its regulated affiliate's competitors) for $7. It is true that in this one instance the regulated company could have had its own risk managers hedge these risks at a fully distributed cost of $6, and therefore it is true that it would pay an extra dollar to its affiliate. Does that mean that the transaction was unreasonable or created an unfair or *unreasonable* advantage? Does that mean that *unreasonable* cross-subsidization in fact occurred?

The issues raised by the Commission's Rules are very fact specific, and the Commission cannot have known the answers to those questions when it imposed a blanket rule that in some instances will cause highly beneficial transactions (like those described above) to be unlawful. One reason the Commission is required to adjudicate whether an act (i.e., a transaction with an affiliate) is unreasonable or amounts to an unfair advantage is that until the facts are adjudicated, it is impossible to know what act was or was not reasonable, or when ratepayers may or may not have been harmed. In the foregoing example, the facts may show that ratepayers were harmed *by the Rules* because the regulated gas company had to buy $10 gas, when a phone call to its affiliate would have yielded a price of only $7.

The APS raise questions that require well-considered answers that are provided only in the adjudicatory fact-finding process that the Legislature has mandated in Section 393.140(5). If the Commission believes it has the infinite wisdom to make these determinations without adjudication, or that the public interest mitigates against requiring adjudication in such instances, then the Commission must convince the Legislature that

the current legislative scheme is flawed. *Springfield Warehouse*, 225 S.W.2d at 795 ("if the interests of the public require a change in the law . . . then it is a matter appropriate for action by the Legislature").

The second situation where the Rules turn Section 393.140(5) upside down involves previously filed rates subject to later challenge in a Section 393.140(5) complaint proceeding. The rates and the rules and regulations in a utility's tariff have the force and effect of law and are presumed reasonable. *Midland Realty Co. v. Kansas City Power & Light*, 300 U.S. 109, 114 (1937), *aff'g* 93 S.W.2d 954 (Mo. 1936). That presumption can be rebutted in a complaint proceeding under Section 393.140(5), and such a proceeding can be brought either by the Commission or by a private complainant (usually a customer). If a complainant now wishes to challenge a utility's existing rates, it can march in armed with the presumption created by the Rules and allege that the Commission must disallow certain costs in the utility's rates associated with affiliate transactions because such costs, by rule, are deemed to have resulted in an unfair advantage. The Commission would presumably be bound to disallow those costs, and thus reduce the utility's rates; otherwise, rates based upon unfair advantages that are unlawful under Section 393.130.3 would remain in effect.

The Commission counters (without citation to any authority) that a complainant on such facts would still have the burden to show that the affiliate transaction is unjust. Resp. Brf. at 75. That statement is simply not true. The existence of the presumption created by the Rules has *discharged that burden for the complainant.* This is directly

contrary to the legislative scheme reflected in the PSC Law that imposes that burden on the complainant. The Commission has no authority or jurisdiction to effectively amend that legislative scheme by rule by shifting a legislatively prescribed burden to the utility. *Springfield Warehouse*, 225 S.W.2d at 794.

C. <u>The effect of the APS is much greater than that of a mere "policy."</u>

As noted above, the Commission and the OPC counter by expressing great modesty about what the APS actually do. They say that they are no more than a "policy" that simply puts utilities "on notice" of how the Commission views transactions between a utility and its affiliates. *See* Resp. Brf. at 71; OPC Brief at 89. The Rules, if duly promulgated and within the Commission's jurisdiction (which the Commission contends they are), carry the force and effect of law. *Fields v. Missouri Power & Light Co.*, 374 S.W.2d 17, 32 (Mo. 1963). If the Commission tried to treat its newly-created rule of law as a mere "policy statement" to the detriment of a complainant in a Section 393.140(5) proceeding, the complainant could successfully appeal on the grounds that the Commission did not follow the law as reflected in its own rules.

When the Commission announces a "policy" in a Commission decision or otherwise, as it apparently did in *Kansas City Power & Light*, Case No. ER-85-185, 28 Mo. P.S.C. (N.S.) 228, 269 (April 23, 1986), cited by the OPC in its Brief, no "law" is made. OPC Brf. at 90. This is because the Commission has no power to declare or enforce any principle of law or equity. *Utility Consumers Council*, 585 S.W.2d at 47. The Commission can, however, *within the scope of its legislatively granted jurisdiction*,

promulgate rules that carry the force of law. Consequently, the Rules created by the Commission are not a mere "policy" statement.

The Commission's "mere policy" argument makes no sense. Policy statements do not result from rulemaking. *Davis & Pierce, Administrative Law Treatise,* §6.2. Rather, policy statements are either just that -- statements of an agency's views (policies) on something that do not bind anyone, *Id.* -- or statements arising from adjudicated cases that the agency may later give precedential effect. *Id.* In either case, the agency is not bound for all time to follow its "policy" because there is no statute or duly promulgated administrative rule carrying the force and effect of law and binding the agency and the public.

Once an administrative rule is promulgated, however, it is binding and can only be changed by amendment or repeal, which must be accomplished with a hearing by the Commission. *Fields*, 374 S.W.2d at 32. Thus, contrary to the Commission's and OPC's suggestion to the contrary, the Commission is not free to decide that its "policy" [which is in fact a rule] should not be followed in a particular case. OPC Brf. at 89. The Rules are not a "policy"; they are an administrative rule, and the Commission cannot rescue their validity by now claiming otherwise.

The OPC attempts to further obscure the reach of the Rules by claiming they have no effect on "corporate support services." OPC Brf. at 96-97. This, too, is inaccurate. The "corporate support" exception to Section 2(B) originated in the OPC's Initial Comments in the rulemakings as the OPC attempted to narrow an overly-broad

prohibition on providing preferential services even if those services involve "corporate support" (L.F. 58-60). After reviewing comments from the utilities, the OPC noted that the utilities had some legitimate concerns about the breadth of the proposed rules relating to preferential treatment (L.F. 226), and that it was necessary to separate the corporate support functions from the operation of the "pricing" (i.e., the asymmetrical pricing) standards of the proposed rules (L.F. 227). To address the pricing issues, the OPC proposed the following additional change to the proposed rules: "Except as necessary to provide corporate support functions, a regulated gas/electric corporation shall not provide a financial advantage to an affiliated entity" (L.F. 227). Had this additional proposal been adopted, a financial advantage in the provision of corporate support services would have been allowed, thus exempting corporate support services from the requirements of the APS. The referenced pages from the Initial and Reply Comments of the OPC referred to above appear in the Appendix at pages A1 to A5.

This additional language was not adopted by the Commission. Thus, the history of the "corporate support" exception plainly shows it does not nullify application of the APS to corporate support services because the carve-out relating to asymmetrical pricing proposed by the OPC was not adopted. Rather, only the OPC's initial "corporate support" exception, which did not address asymmetrical pricing issues, was adopted. As a consequence, the PSC's and the OPC's attempts in their Briefs to suggest that the APS do not apply to "corporate support" services lack credibility.

In addition, the terms of Section 2(B) apply when the utility is providing preferential services, information, or treatment *to* its affiliates. UE does not provide "corporate support services" *to* its affiliates. It *receives* such services *from* Ameren Services. Thus, allowing UE to provide preferential treatment to its affiliates does not alleviate any of the concerns expressed by UE regarding the Rules. And, even if Section 2(B) were re-written, there are several "services" that are not within the inclusive definition of "corporate support services" contained in Section (1)(D) of the Rules. UE obtains numerous other services from Ameren Services as described in Schedule 1 to the General Services Agreement between Ameren Services Company and UE et al.[5] Many of the services listed on Schedule 1 are not listed in the Rules and, in fact, the OPC, in its Initial Comments, took the position that many of the services that UE receives under Schedule 1 (such as employee recruiting, engineering, regulatory affairs, and lobbying, among others) were *not* corporate support services within the meaning of Section 2(B) and therefore would not be exempt from the APS (See subsection (H).4 of the OPC's proposed rule at L.F. 58).

D. The Commission cannot justify an otherwise lawful rule by now arguing that the remedies for its violation may not be enforced.

The Commission makes much of the fact that UE cited remedies available to the Commission for violations of its Rules, and implies that such remedies would never be pursued. Resp. Brf. at 78-79. The Commission does not deny, however, that violation of

[5] See Appendix starting at page A6.

the Rules would, but for the Commission's now-expressed intention to exercise self-restraint, allow it to exercise all remedies at its disposal and rely upon the Rules in doing so. In fact, the Commission so provides in the Rules. *See, e.g*., Section (8)(A). As discussed in UE's Initial Brief (at p. 60), the Commission is simply attempting to deflect attention from the substantive problems with its Rules. Whether or not any or all of the available remedies would ever be at issue is pure speculation. We do know that the Commission has sought penalties before from a utility that failed to follow the Commission's orders. *See, e.g. State v. Davis*, 830 S.W.2d 27 (Mo. App. S.D. 1992). That the Commission may now say, in an effort to win this appeal, that it really does not intend to use any remedy is irrelevant.

Even if, *arguendo*, one assumes that the Commission will exercise prosecutorial restraint, as noted above, private complainants are not similarly bound by the "restraint" the Commission indicates it will exercise, and the courts are bound to follow the law that has been created. And finally, the Rules are effective forever, unless later repealed or amended. The composition of the Commission and other circumstances change over time. In short, to justify flawed Rules on the basis that they can be waived or not enforced or because utilities can "defend themselves" later is poor policy and contrary to law. Resp. Brf. at 78-79.

E. <u>That the Commission might waive compliance in one fashion or another does not reverse the legal effect and consequences of the Rules</u>.

Aside from ignoring that the problem with the Rules comes from their inconsistency with Section 393.140(5), the Commission also attempts to rebut UE's Point II by falling-back on the waiver provisions contained in Section (10) of the Rules (Resp. Brf. at 74). But the mere *possibility* that the Commission *might* choose to grant a waiver, assuming it is requested, cannot cure an otherwise unlawful rule. In addition, the waiver provisions of the Rules are disjointed, unclear, vague, and ineffective.

Before a waiver is possible, the utility must (a) determine (in advance or within 10 days after the transaction occurs) that it needs a waiver (Section 10(A)(1), (2)); (b) fully document both the fair market value and fully distributed cost of the transaction at issue (Section 10(A).2.A and Section (3)(B)); and (c) be granted the waiver (Section 10(A).2.B) ("Any affiliate transaction submitted pursuant to this section shall remain interim, *subject to disallowance*, pending final commission determination . . .." (emphasis added)). A hearing can only be *requested* (Section 10(A).2.B) – the Commission need not grant a hearing at all because it has reserved the power to "grant or deny the request [for a hearing] at that time." *Id.* If the Commission denies a hearing, a "party" (Staff, OPC, or private complainants-apparently any of the above) can clearly challenge the transaction later and the transaction can be disallowed.[6] *Id.* If any one of conditions (a) -

[6]The waiver process referred to in the OPC's Brief (at p. 92) illustrates the problems and risks the utility faces. In the matter cited by the OPC, it took five months after the waiver

(c) as listed in the preceding paragraph is not met, and a complaint is brought under Section 393.140(5), the presumption created by the Rules operates.

The Commission also suggests, without any explanation, that a cost allocation manual ("CAM") somehow allows the utility to avoid the APS. Resp. Brf. at 74. In the first place, that is only true if the regulated utility is *buying* something *from* the unregulated affiliate (Section (3)(D)). There is therefore an entire class of "affiliate transactions" (*sales to* the unregulated affiliate or services *provided to* the unregulated affiliate) that approval of a CAM will not address. Also, what if the Commission does not approve a CAM that deviates from the APS? Again, the Commission places the burden on the utility to come before it and prove a negative, that is, that every affiliate transaction it engages in is *not* unjust and is not unreasonable. The law is, however, that

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request was filed to reach the prehearing conference, and it took more than six months to obtain an agreed-to resolution of the request. During that entire period, a utility is acting at its own risk. The longer the process goes, the greater the number of transactions that are at risk and the more leverage the Commission gains because the utility may find itself facing the choice of either (a) settling the waiver "proceeding" on the Commission's terms or (b) rolling the dice in some kind of "hearing" in which there are no standards. This is a fundamentally different situation than existed before the Rules. Before the Rules, the Commission bore the burden to show the act was unreasonable. If the Rules are upheld, however, the utility will now bear that burden.

if the Commission or a complainant believes the transaction is unjust or unreasonable then they must prove it under Section 393.140(5).

The Rules do not specify when the CAM is to be filed, what it should contain, how the Commission reviews, approves, or rejects it, how long the process takes, or what the utility is supposed to do if transactions are happening or need to happen during the pendency of this undefined process. The Commission would probably suggest that the utility "seek a waiver" in the meantime, but as previously stated, the waiver process has its own very substantial infirmities.

The bottom line is that the Commission is not required to act upon, or grant, a waiver or an alternative in a CAM. Absent such a grant, the utility is deemed to have acted unlawfully. That result essentially negates the provisions of Section 393.140(5) and is therefore unlawful.

The final argument used by the Commission in its attempt to salvage the lawfulness of the APS is grounded on the Commission's repeated and misplaced reliance on cases that recognize its jurisdiction, under Section 393.140(5), to determine *by adjudication* that a utility's acts that result in undue or unreasonable preferences or advantages are unlawful. The Commission apparently mistakenly relies on such cases based on its mistaken belief that UE is arguing that the Commission promulgated the Rules *under* Section 393.140(5). Resp. Brf. at 36-37, 67-70.

UE agrees that the Rules were not promulgated under Section 393.140(5) – in fact, they could not have been because, as UE has consistently argued, Section 393.140(5) is

an adjudicatory statute requiring the Commission in a contested case to determine whether the acts complained of (here, the charges between a regulated utility and its affiliate) result in an *undue or unreasonable* preference or advantage. The Commission's continued reliance upon cases such as *Gen. Tel. Co.*, 537 S.W.2d at 659, to support the proposition that the Commission can, by rule, determine that a particular act results in an undue or unreasonable preference or advantage without reliance upon a single fact to support that determination is unreasonable. The Commission cannot point to a single case (because there are none) where this or any other court has held or even suggested that the Commission has the power to declare by rule that a utility's particular act is, as a matter of law, an undue or unreasonable preference or advantage. Yes, the Commission has the authority to "examine transactions when a utility transacts business with an affiliated entity." Resp. Brf. at 46. And, yes, *Gen. Tel. Co.*, 537 S.W.2d at 655 and *State ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n*, 645 S.W.2d 44 (Mo. App. W.D. 1982), and some other cases, recognize that such an examination can occur, *but only in an adjudication pursuant to Section 393.140(5)* -- the Legislature has given the Commission jurisdiction to declare unlawful acts resulting in undue or unreasonable preferences or advantages but has prescribed the manner in which that jurisdiction must be exercised in Section 393.140(5). "Where a procedure before the Commission is prescribed by statute, that procedure must be followed." *State ex rel. Monsanto v. Pub. Serv. Comm'n*, 716 S.W.2d 791, 796 (Mo. banc. 1986).

The Commission's allegation that UE failed to preserve UE's argument regarding the well-settled judicial principle that precludes the Commission from taking over the management of a utility is also illogical. In its Application for Rehearing before the Commission (the grounds of which were incorporated by reference into its Application for Writ of Review in the circuit court), UE contends that the Rules are unlawful because "there was no determination that AmerenUE's existing practices were unjustly discriminatory or unduly preferential as required under Section 393.140(5) . . ." (L.F. 468). In its Initial Brief, in discussing cases that have applied the requirement that an adjudicated determination that the utility's acts (practices) are unjustly discriminatory or unduly preferential occur, UE noted that the courts in such cases interpret Section 393.140(5) to preclude the Commission from taking over the utility's management. UE's Initial Brief at 66. UE's discussion of its right to manage its own affairs is not a separate "issue" that UE must "preserve" in order to discuss. Rather, it is part and parcel of the law underlying the proper application of Section 393.140(5). The proper application of Section 393.140(5) was quite specifically preserved for review (L.F. 468).

The Commission also suggests that its pre-determination of the propriety of various affiliate transactions by way of the APS does not take over the utility's management, as evidenced by *Laclede Gas Co. v. Pub. Serv. Comm'n*, 600 S.W.2d 222, 228 (Mo. App. W.D. 1980). Resp. Brf. at 77. The Commission, however, confuses an adjudicated finding in a Section 393.140(5) proceeding (the situation in *Laclede*) from an unlawful blanket rule that effectively amends the legislative scheme the Commission

must follow.[7] Adjudications under Section 393.140(5), like all adjudications, rest on evidence of facts – facts that have been established by completed events (here, an affiliate transaction or series of transactions) – and test those facts against the applicable law. Here, the law established by the Legislature in Section 393.140(5) provides that utilities are not to grant undue or unreasonable preferences or advantages. The law also prescribes how the Commission is to exercise its jurisdiction to address any such unlawful advantages – by adjudicating facts under Section 393.140(5). The Rules change that law, a change the Commission has no authority to make.

[7]The Commission similarly incorrectly charges that UE did not preserve its "question" relating to PUHCA. Resp. Brf. at 76. Again, UE discusses PUHCA in the context of illustrating that the APS pre-determine what a utility's management can and cannot do, without determining in an adjudication whether management's actions resulted in an undue or unreasonable preference or advantage. UE's Initial Brief at 69. UE's discussion of PUHCA is again simply a part of an issue that is clearly preserved.

III. THE PSC ERRED IN ISSUING THE ORDERS THAT CREATED THE RULES BECAUSE THE PROCESS FOLLOWED IN ISSUING THE ORDERS AND THE RESULTING RULES VIOLATED MO. REV. STAT. § 386.250(6) IN THAT APPELLANTS, AS AFFECTED PARTIES, WERE DENIED THE RIGHT TO PRESENT EVIDENCE AND TO CROSS-EXAMINE AND REBUT OPPOSING WITNESSES AT AN EVIDENTIARY HEARING.

The Commission states in its brief that it did not promulgate the Rules under Section 393.140(5). Resp. Brf. at 36-37, 67-70; OPC Brf. at 59. UE never contended otherwise, and as noted in Point II above, the Rules cannot be promulgated under Section 393.140(5) because that statute deals exclusively with adjudication.

UE also does not contend that the Rules (other than the APS) should have been conducted as a "contested case" or using "contested case procedures" *under* Section 536.010(2). Rather, UE stated in its Initial Brief that the rulemaking provisions of Chapter 536 are not the final, or only, word on the requirements of an agency rulemaking: the agency's enabling statute may (and in this case does) impose additional requirements.

A. <u>This Court should disregard the Commission's belated reliance on subsection (7) of Section 386.250</u>.

After voluminous initial and reply comments in the rulemaking proceedings, and argument and briefing before the Circuit Court, the Commission now argues that Section

386.250(6) does not apply because the Rules purportedly do not deal with "conditions of rendering public utility service" and that instead, the Commission was actually proceeding under Section 386.250(7). Resp. Brf. at 67-68. That position is a complete turnaround from the Commission's prior arguments, and amounts to an improper post hoc rationalization of the basis of the PSC's orders of rulemaking. *Overton Park*, 401 U.S. at 419; *S.E.C. v. Chenery*, 318 U.S. at 88 (Courts cannot review an agency's action based on grounds other than those upon which the agency *itself* based its action).

When the Commission proposed these Rules it cited as its authority Section 386.250. Missouri Register, Vol. 24, No. 11 (June 1, 1999). In the rulemaking proceedings, the Commission argued that the "hearing" required by Section 386.250*(6)* was a mere "legislative" hearing. *See Reply Comments of the Staff of the Missouri Public Service Commission* at 17 (L.F. 282-84). In making that argument, the following statement was made: "it is true that § 386.250 RSMo (Supp. 1998), *requires* the Commission to promulgate rules *only after a hearing* in which the Commission is to take evidence of the reasonableness of its proposed rule" (L.F. 283) (emphasis added). That statement is followed by a discussion of a Missouri administrative law treatise discussing the fact that many statutes require only a "legislative-style" hearing. *Id.* UE agrees that there are many such statutes, but as UE stated in its Initial Brief, Section 386.250 is not one of them. In fact, the language in Section 386.250 is far different than the language in other such statutes.

In short, the Commission cited Section 386.250 as its authority for the Rules, and in supporting the rules, cited subsection (6) specifically, admitting that because of subsection (6), Section 386.250 requires a hearing. If subsection (7), as the Commission *on appeal* now argues, is the source of the Commission's authority, then why did the Commission discuss subsection (6), admit that it required a hearing, and in effect admit that a hearing was required *with respect to the Rules at issue in this case?* Notwithstanding its belated attempt on appeal to argue otherwise, it is clear that the Commission issued these rules under subsection (6), that subsection (6) did -- and still does -- apply, and the Commission's actions must therefore be tested with respect to whether the PSC has properly followed the requirements of subsection (6).

The Commission has also cited Section 393.140(11) in support of its rulemaking authority in these cases. Resp. Brf. at 69-70. Subsection (11), however, has nothing to do with affiliate transactions. It deals exclusively with rate schedule forms, i.e., tariff requirements.[8] OPC joins in this ever-evolving attempt to statutorily justify these Rules (by some means other than reliance on Section 386.250(6)) by noting that the Commission previously claimed it was proceeding under its "general authority" (L.F. 443-447). Based on that contention, OPC attempts to rescue the Commission and concludes that "general authority" means Section 386.250(7). OPC Brf. at 33-34. The

[8]The statute gives the Commission the power to "establish such rules and regulations, to *carry into effect the provisions of this subdivision [11]*, as it may deem necessary . . ." (emphasis added).

mere fact that the Commission may now say that it is proceeding under Section 386.250(7), however, does not make it so. The Commission does not create legislative authority for its rules. Rather, the Legislature does, and that authority must come from a statute. Section 536.014.

B. Section 386.250(6) applies.

The Rules themselves refute the Commission's contention in any event. It is true that parts of the Rules deal with recordkeeping and other matters dealing with communications between the Commission and the utility. Other parts of the Rules plainly deal with the utilities' dealings with their customers, however, and therefore plainly deal with the rendering by the utilities of services to those customers.[9]

[9]For example, the Rule applicable to gas utilities (of which UE is one) (4 C.S.R. 240-40.016) includes provisions that (a) specify how a gas utility must process requests for transportation service in order to avoid granting a preference to any customer (Section 2(E)); (b) how a utility must administer its transportation tariffs generally in order to accomplish the same result (Section 2(d)); (c) how it must disclose transportation related information to customers using a marketing affiliate (Section 2(G)); (d) how and under what circumstances it may provide a rate discount to a transportation customer, including the specific requirements that must be maintained in connection with the transaction (Section 2(H)); (e) how it must administer any discretionary waivers under its transportation tariffs in order to avoid granting of any preference to any customer (Section 2(L)); and (f) how it must communicate with its customers in order to ensure

Furthermore, the Rules, as discussed in UE's Initial Brief and in this Reply Brief, have a direct impact on the utility's rates and the costs on which those rates are based and therefore directly impact the utilities' provision of their public utility services.

In short, Section 386.250(6) applies. Section 386.250(6) does not provide merely for "a hearing." UE will not repeat here the arguments made at pages 70-73 of its Initial Brief, as the PSC has failed to rebut any of those arguments because it continues to deny (a) that the minimal rulemaking procedures called for by Chapter 536 are just that – minimal – and can be supplemented by other law and (b) that the rulemakings at issue in the present case are subject to Section 386.250(6).[10] The Commission's brief provides but one example of the Commission's blindness (willful or otherwise) to the requirements of its enabling statute.

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that the customer will not expect to receive any advantage or preference as a result of doing business with an affiliate of the utility (Section 2(N)). All of the Rules prescribe how the regulated utilities will treat information pertaining to the regulated customers, what the policies will be regarding information relating to regulated customers, and how the utilities will respond to requests for information from its regulated customers. *See*, *e.g.*, 4 C.S.R. 240-20.015(2)(C), (5)(A).7, and (2)(E).

[10]Contrary to the PSC's suggestion otherwise (PSC Brf. at 39), the mention of Chapter 536 in Section 386.250(6) does not indicate an intention to apply all of Chapter 536 to Section 386.250(6) proceedings, or to override Section 386.250(6). See UE's Initial Brf. at 47-49.

The Commission suggests that it met all requirements imposed on it by law by rounds of comments and holding three days of "public" hearings." Resp. Brf. at 35; Resp. Brf. Point I. Not a single statute cited by the principal authority relied upon by the Commission, Professor Neely's treatise, contains the specific and more detailed requirements contained in Section 386.250(6). Section 386.250(6) does not refer to a "public hearing." It refers to the ability of "affected *parties*" to be able to "*present evidence*" and to rules that are to be "supported by evidence as to reasonableness . . .." A court must give effect, if possible, to every word in a statute. *Hovis v. Daves*, 14 S.W.3d 593, 595 (Mo. banc 2000). Giving effect to the legislative language at issue here demonstrates that the legislature obviously intended much more than the minimal "public hearing" that many other statutes require.

In the case of *these* Rules issued by *this* agency, such additional requirements apply and were not followed. These Rules are therefore invalid.

C. The Commission and OPC are incorrect in now also improperly relying upon Section 386.410.1.

In their Briefs in this Court[11] both the Commission and OPC advance an entirely new argument, contending that Section 386.410.1 excuses the Commission from the

[11]UE respectively suggests that the Commission's/OPC's 386.410.1 argument should be disregarded as it violates this Court's Rule 83.08 because it alters the basis of their claim and was not raised in the Court of Appeals.

requirements that the Commission allow affected parties to present evidence as required by Section 386.250(6).

In *State ex rel. Fischer v. Pub. Serv. Comm'n*, 6705 S.W.2d 24 (Mo. App. W.D. 1984), the Western District rebuffed a similar attempt by the Commission to improperly use Section 386.410 to override mandatory provisions of the PSC Law. In *Fischer*, the OPC challenged a Commission order on the grounds that the Commission had failed to follow the particular hearing requirements provided for in Section 386.420. *Id.* At 42. The Commission had allowed only a "limited hearing" and in support of its actions argued, as it does here, that the provisions of Section 386.410 allowed it to deviate from the otherwise applicable requirements of Section 386.420. *Id.* The Western District disagreed, stating that Section 386.410 "does not, as the Commission claims, give it unlimited discretion to conduct its hearings in any possible manner. Rather, it gives the Commission flexibility in its proceedings, *as long as its proceedings satisfy other statutory requirements"* (emphasis added).

In this case, the other statutory requirements are contained in Section 386.250(6). Section 386.410 does not authorize the Commission to ignore those requirements.

CONCLUSION

The Commission is without jurisdiction to nullify the express will of the Legislature by shifting the burden with regard to unreasonable or undue preferences or advantages to the utility. If the Commission or a complainant believes an affiliate transaction creates an unreasonable or undue preference or advantage, they must

adjudicate that issue via complaint under Section 393.140(5). At a minimum, the foregoing extrajurisdictional acts render the APS void.

Furthermore, the entire rulemakings are void because the Commission failed to follow the mandatory rulemaking requirements that *it* must follow under Section 386.250(6).

This Court should therefore enter its order declaring the Orders and the Rules issued thereby void.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a printed copy of the foregoing Substitute Reply Brief of Appellants Ameren Corporation and Union Electric Company, d/b/a AmerenUE and a copy of said Brief on disk were served on June ____, 2002, via United States mail on the following counsel:

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CERTIFICATE PURSUANT TO RULES 84.06(c) AND 84.06(g)

I hereby certify that the foregoing Substitute Reply Brief of Appellants Ameren Corporation and Union Electric Company d/b/a AmerenUE complies with the limitations contained in Rule 84.06(b) and, according to the word count of the word-processing system used to prepare the Brief (excepting therefrom the cover, certificate of service, this certificate, and the signature block and the appendix), contains 7,722 words. I hereby further certify that the disk containing this Brief and submitted to the Court has been scanned for viruses and that the scan indicated that it is virus free.

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